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Get Beyond Policy Uncertainty: Evidence from Political Connections

Hua Cheng
Nankai University

Kishore Gawande
University of Texas at Austin

Steven Ongena
University of Zurich, Swiss Finance Institute, KU Leuven, and CEPR

Shusen Qi
Xiamen University

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Hua Cheng (Nankai University), Kishore Gawande (University of Texas-Austin), Steven Ongena (University of Zurich, SFI, KU Leuven, CEPR), Shusen Qi (Xiamen University)*

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JEL classification: G21; G28; H70

Keywords: Policy uncertainty; Political connections; Bank risk-taking

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Corresponding author: Shusen Qi, School of Management, Xiamen University, No. 422 Siming South Road, 361001 Xiamen, Fujian, China. Email: shusenqi@xmu.edu.cn. Tel: (86) 18030187751.

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1. Introduction

In the aftermath of the global financial crisis, concerns about policy uncertainty have intensified and drawn regulators' attention. As indicated by Baker et al. (2016), both the Federal Open Market Committee and the International Monetary Fund suggest that uncertainty about fiscal, regulatory, and monetary policy decisions were major contributors both to the steep economic decline in 2008–2009 and the slow recoveries afterwards. Many scholars, including Rodrik (1991), Hassett and Metcalf (1999), Pastor and Veronesi (2012), Waisman et al. (2015), Gulen and Ion (2016), Nguyen and Phan (2017), Bonaime et al. (2018), and Nguyen et al. (2018), treat policy uncertainty as detrimental for economic growth.

Although these studies provide useful insights on the impact of uncertainty on firms and the real economy, some of these adverse effects may reflect the indirect effects on corporate behavior of any reduced bank output. That is, part of the observed reductions in economic activity may be due to changed bank behavior, rather than to any direct effects on firms. But we still know relatively little about how policy-induced economic uncertainty might influence the decision-making of financial institutions. Only a few papers have focused on this aspect. Bordo et al. (2016), for example, document a negative effect of policy uncertainty on bank lending, while Berger et al. (2018) show that policy uncertainty reduces the supply of banking services.

This paper tries to extend this literature by examining how political connections could mitigate the adverse impact of policy uncertainty on banks. From a theoretical perspective, ex ante, access to political insiders can provide banks with better access to legislative proposals under consideration. Politically connected banks can also gain a superior understanding of how policymakers will react to various alternatives, and thus assess the likelihood of legislative outcomes with greater precision. In both ways, connected banks would face a reduced level of policy uncertainty compared to their unconnected counterparts. Ex post, the adverse effect of policy uncertainty comes from the potential cost of making the "wrong" decision, but this cost can be mitigated if the bank is politically connected. There is ample empirical evidence that politically connected banks enjoy a higher probability of bailout in times of distress. So, a moral hazard–based theory would predict politically connected banks to be less conservative in the face of policy uncertainty compared to their

unconnected competitors. Taking these observations together, we hypothesize that the adverse effect of economic policy uncertainty would be less severe for politically connected banks.

To test this question empirically, we rely on a full sample of commercial banks and savings' institutions in the US over a 29-year period. Policy uncertainty is measured by the newspaper-based economic policy uncertainty (EPU) index proposed and constructed by Baker et al. (2016). To capture banks' political connections, we follow Cohen et al. (2011), Duchin and Sosyura (2012), and Kostovetsky (2015), to use a geographic-based measure of political connections: whether a bank is headquartered in a state with a senator on the influential Senate Committee on Banking, Housing, and Urban Affairs (hereafter "Senate Banking Committee"). Finally, banks' reactions are captured by their risk-taking behaviors, as measured by the loss provision to loan volume ratio (Dinger and Von Hagen, 2009; Houston et al., 2010; Casu et al., 2011; Klomp and Haan, 2012; Khan et al., 2017).

In line with previous studies, we find banks to be more conservative when facing policy uncertainty. Economically, a one standard deviation increase in policy uncertainty increases banks' loss provision to loan volume ratio by 15 percent. What is new and interesting is that the adverse effect of policy uncertainty on banks is alleviated partially when banks are politically connected, despite the fact that, in general, connected banks are more cautious. For an increase of one standard deviation in the policy-uncertainty index, connected banks would maintain a loss provision to loan volume ratio that is almost seven percent lower compared to the unconnected banks.

We then conduct several robustness checks to validate our findings. First, we apply a geographical regression discontinuity design, following Holmes (1998) and Mian et al. (2015), to address the potential endogeneity concern that Senate Banking Committee representation might not be assigned randomly across different states. Specifically, we restrict our sample to counties that are geographically close to either side of a state border. These nearby counties are more similar to each other than they are to counties farther away from the borders. So, when we compare banks located in these counties, it is less likely that Senate Banking Committee representation captures some omitted across-state differences. In other words, the assignment of Senate Banking Committee representation is more random among these banks close to state borders. The findings are very similar, both statistically and economically.

Similarly, in another robustness check, we exclude New York State from our regression because it is a financial industry hub and is the only state that always gets Senate Banking Committee representation. We also drop the states that have never got representation in the Senate Banking Committee. Both of these subsample analyses are designed to further exclude the possible bias of the unevenly dispersed committee connections that may relate to omitted state level characteristics. Again, the findings remain unaffected.

Second, we conduct a placebo test where the Senate Banking Committee is replaced by other powerful, but unrelated, committees, such as the Senate Committee on Agriculture, Nutrition, and Forestry (hereafter "Senate Agriculture Committee") and the Senate Committee on Energy and Natural Resources (hereafter "Senate Energy Committee"). The rational is that if our prediction is correct, the mitigation impact should come only from connections to relevant politicians, and not from committee representations that are irrelevant to the banking sector. The estimates are in line with this expectation that connections to unrelated committees do not contribute to the mitigation of policy uncertainty.

We further corroborate our findings by examining the heterogeneity across banks of different sizes and over time with changing levels of regulatory strictness. First, from a practical perspective, compared to smaller banks, larger banks often operate beyond state borders and are able to exert influence over senators in other states. Larger banks may also get connections with regulators of the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve System. In contrast, smaller banks, which operate mostly within their home states, are more likely to be affected by their home state representation in the Senate Banking Committee. Indeed, we find our results to be driven mainly by smaller banks, rather than larger ones.

Second, banking regulation has evolved dramatically in the US. In the early years, the banking sector was regulated heavily. The Gramm–Leach–Bliley Act, enacted on November 12, 1999, repealed part of the Glass–Steagall Act of 1933, removing barriers to consolidation among commercial banks, investment banks, securities' firms, and insurance companies. So, since 2000, the banking market in the US was less regulated and became more volatile, leading finally to the 2008/09 global financial crisis. In response to the crisis, the Dodd–Frank Wall Street Reform and Consumer Protection Act was enacted on July 21, 2010. The law overhauled the financial

regulation in the aftermath of the financial crisis, and it made changes affecting all federal financial regulatory agencies and almost every part of the nation's financial services' industry. Once again, regulation of the banking market became stricter. Theoretically, rent arising from political connections would decrease during times of loosened regulations, so the role of political connections in mitigating the effect of policy uncertainty should be less pronounced. This is supported by our findings that the impact was stronger before 2000 and after 2010, but somehow disappeared in between these years.

Our paper contributes to at least two strands of literature. The first is research on the impact of policy uncertainty on firms and economic activities. Theoretical work on this topic dates back to Bernanke (1983) and is followed by many papers, including Rodrik (1991), Hassett and Metcalf (1999), Bloom (2009), Bachmann et al., (2013), Born and Pfeifer (2014), Fernández-Villaverde et al. (2015), Scotti (2016), Jens (2017), and Bloom et al. (2018). However, part of the observed reductions in economic activity may be a result of changed bank behavior, and very little is known about the way in which policy uncertainty might influence the behavior of financial institutions (Bordo et al., 2016; Berger et al., 2018). There is also a clear lack of research identifying ways to alleviate the adverse effect of policy uncertainty. Therefore, our paper contributes to this strand of the literature by examining how policy uncertainty adversely affects banks' risk-taking behavior, and, more importantly, the role of political connections in mitigating this adverse impact of policy uncertainty on banks.

Second, we contribute to the literature on the economic impact of political connections. In her seminal work, Johnson (1960) describes how economic agents receive favorable treatment over their competitors through government means. Many empirical studies have verified the benefits of political connections. For example, Faccio et al. (2006) find that politically connected agents are significantly more likely to be bailed out than are similar unconnected peers. Regulators are also much less likely to initiate enforcement actions against politically connected banks (Lambert, 2019). These studies largely focus on government actions; however, our paper shows that having political connections in place would also affect the behavior of the economic agents, especially in times of high policy uncertainty. In other words, we show that political connections can benefit banks via mitigating the adverse effect of economic policy uncertainty.

Our research is also policy-relevant. Regulators have realized the detrimental impact of economic policy uncertainty for firms and the economy as a whole. Government authorities are taking various actions to reduce the level of uncertainty in their legislative processes. However, little is known about how financial institutions react to these uncertainties, and even less is known about how to deal with the adverse effects of policy uncertainty from the perspective of the economic agents. In this paper, we show that the detrimental impact of policy uncertainty on banks could be partially mitigated by political connections. Theoretically, political connections can help to directly reduce the uncertainty that banks face in the legislative process, which is beneficial. However, access to political resources might also reduce the cost of making the "wrong" decision and induce banks to take on more risk. This moral hazard issue may harm the stability of the financial system and significantly increase the tax burden, because government bailouts of banks are costly (Blau et al., 2013).

The rest of the paper is organized as follows. Section 2 lays out our hypothesis. A data description and summary statistics are presented in Section 3. Section 4 presents the methodology and results. Finally, Section 5 concludes.

2. Hypothesis

As indicated by Baker et al. (2016), both the Federal Open Market Committee and the International Monetary Fund have blamed economic policy uncertainty as a major contributor to not only the 2008/09 global financial crisis but also the slow recoveries afterwards. Since then, many scholars have noticed the disruptive effect of policy uncertainty on firms and economic activities. As a result, the ability to cope with uncertainties surrounding economic policy decisions is becoming indispensable for any modern firm. Therefore, market participants need to adjust their actions when they face significant uncertainty regarding the timing, content, and impact of policy decisions by regulators.

The impact is likely to be stronger for banks, as the banking industry in most countries is subject to a tight set of regulations. In addition to the general economic policies that affect the universe of firms, regulations such as bailout policies, capital–reserve requirements, and entry restrictions will

all directly and specifically affect banks. However, the adverse effects of economic policy uncertainty on banks could be mitigated via political connections, both ex ante and ex post.

Ex ante, access to political insiders can directly reduce the level of policy uncertainty that banks face. Uncertainty comes from information asymmetry, or, in other words, the heterogeneity in policy alternatives that regulators face and the difficulty in predicting regulators' response to these alternatives (Wellman, 2017). When considering the choice among various policy alternatives, regulators face difficulties over how the market will react to their policy decisions and what the real impacts of their decisions are (Hillman and Hitt, 1999). To reduce these difficulties, regulators have an opportunity to engage in communication with market participants to discover their policy preferences and the expected consequences of the policy decisions (Schuler et al., 2002).

However, it is unlikely that all market participants will have an equal opportunity for communication. In practice, as shown by Hillman and Hitt (1999), better access is often granted to those banks that maintain good working relationships, or have close ties, with regulators. Therefore, political connections can provide banks with increased ability to interact with regulators and, hence, superior access to legislative information.

Political connections can further decrease the level of policy uncertainty by influencing the quality of information received. For instance, connected banks can enjoy "face time" with high-ranked officers in regulatory institutions, rather than a member of their staff (Hojnacki and Kimball, 2001). Moreover, though the legislative process can produce an abundance of information and possible alternatives, connected banks would have a greater understanding of the regulators' policy preferences (Austen-Smith, 1995). This increased understanding of the factors that comprise the policymaker's objective function allows connected banks to assess the likelihood of certain legislative outcomes with greater precision. Therefore, politically connected banks not only enjoy differential access to the legislative proposals under consideration but also gain a better understanding of how policymakers will react to various alternatives and ultimately reduce the level of policy uncertainty they face.

Ex post, politically connected banks are better protected even if they have made the "wrong" decision when facing economic policy uncertainty. In other words, political connections can

mitigate the adverse effects of policy uncertainty via providing banks with stronger protection. Theoretical work on the impact of policy uncertainty dates back to Bernanke (1983). In his model, decisions are irreversible and cannot be altered once pursued. But useful information in assessing the "correctness" of the decision only arrives over time. By waiting, firms become more informed and are more likely to make the "correct" decision. Under these conditions, firms trade off the returns from early commitment against the cost of making the "wrong" decision by not waiting for additional information.

However, the cost of making the "wrong" decision can be mitigated if the bank is politically connected. Empirical evidence has shown that politically connected banks enjoy a higher probability of bailout in times of distress. Using a cross-country sample, this is confirmed by Faccio et al. (2006). Dam and Koetter (2012) further show that the risk-taking behavior by German banks responds to changes in bailout expectations from political connections. Therefore, the cost of making the "wrong" decision is much lower for banks with political connections, so they would be less affected by economic policy uncertainty. A moral hazard–based theory would predict politically connected banks to be less conservative in the face of policy uncertainty.

We now take the Troubled Asset Relief Program (TARP), as a result of the 2008/09 crisis, when economic policy uncertainty was rather high, as an example to show how political connections can mitigate the adverse effects of policy uncertainty in practice.

It is well known that deliberations on such a government intervention took place largely in private meetings between regulators and selected financial institutions (Jagolinzer et al., 2020). More importantly, details regarding the application and qualification process for funds from TARP were not publicly disclosed. So ex ante, either banks with good working experience with the regulators or those with closer ties are more likely to be involved in the legislative process. As a result, connected banks are likely to be more informed, which directly reduces the level of uncertainty. Ex post, political connections appear to have also played a role in the allocation of TARP funds (Sorkin, 2010; Duchin and Sosyura, 2012). For example, Duchin and Sosyura (2012) find that banks' connections to powerful government officials in Congress and to the Federal Reserve System correspond to a higher likelihood of receiving TARP capital. In other words, banks with better political connections are more likely to be saved when they are in distress. Thus, connected banks

are less affected by policy uncertainty because the cost of making the "wrong" decision is lower, and they can take on more risk when facing it.

Taking these observations together, we hypothesize that the adverse effect of economic policy uncertainty is less severe for politically connected banks.

3. Data and Summary Statistics

Measuring the policy uncertainty generated by regulatory and political systems has been challenging for scholars. The main challenge is the difficulty to disentangle policy-induced uncertainty from general economic uncertainty, such as stock market volatility. Another difficulty is that it is not clear which events should be classified as causing policy-induced uncertainty, and nor is it clear how to measure the degree of policy uncertainty that an event may cause. In this paper, we measure *Policy uncertainty* by the innovative EPU of Baker et al. (2016), which is based on textual analysis of newspaper articles. Detailed variable definitions and data sources can be found in Table 1.

[Insert Table 1 about here]

This economic policy uncertainty index is able to capture uncertainty about who will make economic policy decisions, what economic policy actions will be undertaken and when, and the economic effects of these policy actions or inactions. As a result, this policy uncertainty index has significantly promoted research on the consequences of policy uncertainty in several recent studies (Gulen and Ion, 2016; Julio and Yook, 2016; Nguyen and Phan, 2017; Bonaime et al., 2018; Nguyen et al., 2018). For ease of interpretation, we standardize the *Policy uncertainty* index by subtracting its time-series mean and dividing by its standard deviation. The time-series trend of economic policy uncertainty in the US is presented in Figure 1. For example, we see a huge spike in uncertainty during the 2008/09 global financial crisis.

[Insert Figure 1 about here]

To capture banks' political connections, we follow Cohen et al. (2011), Duchin and Sosyura (2012), and Kostovetsky (2015), to use a geographic-based measure of political connections; that is,

whether a bank is headquartered in a state with a senator on the Senate Banking Committee. In the US, each state is represented by two senators, but not all senators have the same power to assist the banks headquartered in their home states. A major amount of such power comes from a seat on the relevant Senate Banking Committee. The committee's areas of jurisdiction include banking, insurance, financial markets, securities, international trade and finance, and economic policy. Members of the committee write legislation in these areas and oversee the executive departments and other government agencies regulating the financial industry. These oversight powers provide Senate Banking Committee members with a great deal of leverage to influence government decisions that affect the financial industry.

Specifically, the historical membership of the Senate Banking Committee is drawn from the annual volumes of the Official Congressional Directory. The Directory lists the names (and the home states) of each senator on each Senate committee. For each bank in a certain quarter of a year, we define the dummy, *Connected bank*, which equals 1 if the bank is headquartered in a state with a senator on the Senate Banking Committee and 0 otherwise. As shown in Table 2, on average, approximately 44 percent of banks have Senate Banking Committee representation in a certain quarter of a year.

[Insert Table 2 about here]

As pointed out by Kostovetsky (2015), there are three reasons why the use of Senate Banking Committee representation is a proper measure of banks' political connections. First, committee members have strong power to affect the banking industry. The committee's legislative record includes the major acts that govern the banking industry. Examples include the 1980 Depository Institutions Deregulation and Monetary Control Act, which phased out interest rate ceilings on deposits, expanded powers over thrifts, and raised the deposit insurance coverage to $100,000; the 1994 Riegle–Neal Interstate Banking and Branching Efficiency Act that permitted interstate expansion; the 1999 Gramm–Leach–Bliley Act, which allowed financial holding companies to offer banking, securities, and insurance products under one corporate roof; and the legislation on and oversight of the TARP program during the 2008/09 financial crisis.

Second, even after the bank branching deregulation that came after the 1980s, most banks still operate within state boundaries and often have the name of the state in their names, e.g., First Texas Bank. So, it is appropriate to look at senators who represent individual states. Banks that are located in a state with a senator on the Senate Banking Committee potentially have a powerful ally that can either reduce the level of policy uncertainty by revealing superior information or improve their chances of survival when they are in distress. In addition, it is very unlikely that banks move across state borders to exploit the potential benefits from Senate Banking Committee representation, because the cost of moving from one state to another is rather high.

Third, having a connection to the Senate Banking Committee is not a choice variable of the bank. The banking industry is well dispersed across the US, much better than in most other industries, so the Banking Committee representation is not significantly related to the density of banks. This is shown in Figure 2. We can see that the membership of the Senate Banking Committee includes senators from most regions of the country, from large states and from small states, from largely urban states and from largely rural states, with different levels of bank density. This is in contrast with the Agriculture or Energy Committee, where the committee representation is mostly from farm and oil states. According to the Congressional Research Service Report for Congress, for committees such as Banking, a senator is mainly assigned to a committee to "match the legislator's skills, expertise, and policy concerns."

[Insert Figure 2 about here]

To capture how banks are affected by policy uncertainty and their resulting risk-taking behaviors, we utilize the loss provision to loan volume ratio (*Loss provision/Loan volume*), which has been applied widely in previous studies (Dinger and Von Hagen, 2009; Houston et al., 2010; Casu et al., 2011; Klomp and Haan, 2012; Khan et al., 2017). Banks are financial intermediaries that primarily collect deposits and issue loans to individuals, firms, and governments to finance their consumption or investment. As a result, banks are vulnerable to loan default arising from either deteriorating economic conditions or idiosyncratic risks, which affects borrowers' ability to repay, requiring banks to maintain sufficient loss provisions in anticipation of expected loan losses (Laeven and Majnoni, 2003). Intuitively, high loss provision to loan volume ratios are able to increase banks' ability to absorb losses without either becoming financially distressed or failing, if all else is held

constant (Koch and Wall, 2000). Due to the forward-looking nature of loss provisions, together with the fact that bank managers have significant discretion in the determination of the estimates, changes in loss provision to loan volume ratios are able to reflect the changes in banks' risk-taking behaviors.

From the regulators perspective, loss provision to loan volume ratios have also been important throughout the Basel Accords. Loan loss provisions account for 1.25 percent of risk-weighted assets in Tier 2 capital under Basel I. The inclusion of loss provisions in the computation of regulatory capital allow banks with low regulatory capital to increase loss provisions as a compensation. Under Basel II, the provisioning model anticipates loan losses before they materialize. In the standardized approach, banks include loss provisions up to a maximum of 1.25 percent of risk-weighted assets. More recently, in Basel III, loss provisions are determined based on the expected through-the-cycle loan loss provisioning system. This provisioning system anticipates expected losses and requires banks to set aside specific provisions on newly-originated loans based on individual borrower characteristics that drive the performance of the loans.

Regarding the controls, we include a set of bank characteristics, such as *Total assets*, *ROA*, *ROA volatility*, *Dividend ratio*, and *Cash ratio*, which might also affect banks' risk-taking behaviors. For example, larger banks are likely to grant more loans even without a commensurate increase in loss provisions. ROA may have a positive impact on loan volume and a negative impact on loss provisions, whereas the converse is true for the volatility of ROA. In addition, dividend-paying banks may have a higher level of loss provisions, which could be attributed to having more resources, and they may also be more conservative in lending. Finally, to achieve more cash reserves, banks may reduce both loan volume and loss provisions. All banking information is obtained from the quarterly Call & Thrift Financial Reports and the Summary of Deposits, issued by the FDIC. Our final sample covers all commercial banks and savings' institutions in the US over a 29-year period (from 1985 to 2013).

4. Methodology and Results

4.1 Methodology

To empirically test our hypothesis that political connections can mitigate the adverse effect of policy uncertainty for banks, we estimate the following regression model:

$$Loss\ provision/Loan\ volume_{isyq} = \alpha_q + \alpha_{s/i} +$$

$$\beta_1 Policy\ uncertainty_{yq} * Connected\ bank_{isyq} + \beta_2 Policy\ uncertainty_{yq}$$

$$+\beta_3 Connected\ bank_{isyq} + \beta_4 X_{isyq} + \varepsilon_{isyq} \qquad (1)$$

where bank *i* is headquartered in state *s* in year *y* and quarter *q*. In addition to the set of bank-level control variables, we include the quarter fixed effects for possible seasoning effects that may bias our estimates. In different specifications, we also include state or bank fixed effects to tease out all time-invariant differences across states or banks. Finally, standard errors are clustered at the bank level.

This is a semi difference-in-differences setting where we are interested in whether politically connected banks are less cautious than are their unconnected peers in times of high policy uncertainty. So, before turning to the multivariate estimations, we start with a univariate analysis that can give us a vivid illustration of this difference-in-differences setting. The results are presented in Table 3, where we divide our sample into periods with high or low levels of policy uncertainty (based on whether *Policy uncertainty* is above or below its time-series mean). The variable of interest is the *Loss provision/Loan volume* ratio.

[Insert Table 3 about here]

In the first layer of difference, we find that banks are taking a significantly higher loss provision to loan volume ratio in periods with high policy uncertainty, irrespective of whether the bank is politically connected. The second layer of difference comes from the comparison between connected and unconnected banks. In times of high policy uncertainty, unconnected banks increase their loss provision to loan volume ratio by 0.37 percent, whereas the increase is only 0.19 percent for connected banks. In other words, when facing high policy uncertainty, politically connected banks would maintain a loss provision to loan volume ratio that is 0.18 percent lower than is that of their unconnected competitors. Again, the difference is significant at the 1 percent level. Taken

together, the univariate results validate our difference-in-differences setting and indicate that political connections are indeed able to mitigate the adverse effect of policy uncertainty on banks.

4.2. Baseline Results

The multivariate results are presented in Table 4. We start with a basic specification where no fixed effects are included. Then, quarter fixed effects are controlled for the seasonal effects, together with state fixed effects. In another specification, we replace state fixed effects with bank fixed effects. In columns (1)–(3), we first validate that banks are more cautious during times of high policy uncertainty, which is consistent with previous studies. In other words, when facing a higher level of uncertainty regarding policy decisions, banks are likely to apply a more conservative loan loss provision strategy. Economically, with a one standard deviation increase in policy uncertainty, banks increase their loss provision to loan volume ratio by 15 percent compared to its mean.

Then, in columns (4)–(6), we continue to test our hypothesis that political connections can mitigate the adverse effects of policy uncertainty on banks. In line with our hypothesis, the estimates show that politically connected banks are less conservative than are their unconnected peers in times of high policy uncertainty. Economically, with a one standard deviation increase in the level of policy uncertainty, connected banks would maintain a loss provision to loan volume ratio that is almost 7 percent lower compared to the unconnected banks. Therefore, the findings support our hypothesis that political connections can mitigate the adverse effects of economic policy uncertainty on banks. We also find that in stable times, politically connected banks are more cautious in respect of lending than are their unconnected competitors.

[Insert Table 4 about here]

Turning to other covariates, we find that larger banks (higher *Total assets*) and more profitable banks (higher *ROA*) are, in general more aggressive, in that they maintain a lower loss provision to loan volume ratio. But banks with higher volatility of ROA are found to be more conservative in lending. Similarly, banks that pay out more dividends (higher *Dividend ratio*) and have more cash reserves (higher *Cash ratio*) tend to maintain a higher level of loss provision to loan volume ratio and, thus, are also more cautious in their lending. These results are mostly consistent with the usual

findings in the literature (e.g., Kostovetsky, 2015; Bordo et al., 2016). In the latter tables, we omit the estimates for these covariates.

In Table A1 of the appendix, we further disentangle the two components of the loss provision to loan volume ratio and find significant results for both components. When facing an increase in the level of economic policy uncertainty, in general, banks cut their lending, which is in line with the findings of Bordo et al. (2016) and Berger et al. (2018). At the same time, banks also increase their levels of loss provision to provide more cushioning for potential negative outcomes in the future. However, these adverse effects of policy uncertainty are mitigated significantly if a bank is politically connected. For connected banks, the negative impact of policy uncertainty on loan volume is reduced significantly and is close to disappearing. Connected banks also impose a smaller increase in their loss provisions. Taken together, the decomposition indicates that the impacts of policy uncertainty and political connections materialize through both loan volumes and loss provisions.

4.3. Robustness Checks

Even though we have shown in Figure 2 that the banking industry is much better dispersed than are most other industries in the US, and the density of banks is not correlated with the Senate Banking Committee representation, one may still be concerned that new senators might base their choice of committee assignment on certain characteristics of their home states This would create a spurious correlation between committee membership and banks' risk-taking behavior because the conjecture we investigate treats the Senate Banking Committee as an exogenous variable. In other words, there is a potential endogeneity concern that Senate Banking Committee representation might not be assigned randomly across different states.

To address this issue, we apply a geographical regression discontinuity design, as in Holmes (1998) and Mian et al. (2015), to restrict our sample to counties that are geographically close to either side of a state border. The rationale is that counties close to the same state border are generally more similar to each other than they are to counties that are farther away from the borders. Therefore, when we restrict our sample to only those banks located in these border counties, Senate Banking Committee representation is less likely to capture the impact of unobserved differences across

states. In other words, the assignment of Senate Banking Committee representation is more random among those banks that are close to state borders.

Specifically, we obtain each county's distance to a state border from Holmes (1998) and keep only the samples of banks (first) within 40 km and (second) within 50 km of a state border. These two numbers correspond to the mean and median US county width. Theoretically, the banking markets in these border countries are likely to be more homogeneous and, thus the allocation of Senate Banking Committee is more likely to be random. The estimates are presented in Table 5. We find similar results to those in Table 4, both statistically and economically.

[Insert Table 5 about here]

New York State is a financial industry hub and, from Figure 2, we find it to be the only state that always gets a Senate Banking Committee representation during our sampling period. There are also some states that never get a senator in the Banking Committee from 1976 (when the Call reports began to be released) until the end of our sampling period; these states include Alaska, Arizona, Arkansas, Iowa, Maine, Vermont, and Washington DC.[1] So, the assignment of Senate Banking Committee representation in both New York State and these never-connected states may not be random. To address this concern, in Table 6, we apply three subsample analyses to exclude either New York State or those never-connected states, or both, to further address the possible bias of the unevenly dispersed committee connections that may relate to omitted state level characteristics. Again, the findings remain unaffected, both from a statistical perspective and from an economical point of view.

[Insert Table 6 about here]

We also conduct a placebo test, where the Senate Banking Committee is replaced by two other powerful, but unrelated, US committees (Senate Agriculture Committee and Senate Energy Committee). This is to address potential concern that our measure of political connections simply reflects the general power of a certain state, thereby invalidating our hypothesis. The Senate

[1] Except for Washington DC, the other six states mentioned above (Alaska, Arizona, Arkansas, Iowa, Maine, and Vermont) were also once connected in the Banking Committee before 1976.

Agriculture Committee is empowered with legislative oversight of all matters relating to the nation's agriculture industry, farming programs, forestry and logging, and legislation relating to nutrition and health. The Senate Energy Committee has jurisdiction over matters related to energy and nuclear waste policy, territorial policy, native Hawaiian matters, and public lands.

Both committees are not related to affairs either in the banking industry or, even more generally, in the financial sector; thus, if our hypothesis is valid, we would expect to find no significant impact on reducing the adverse effects of policy uncertainty. In other words, if our prediction is correct, the mitigation impact should come only from connections to relevant politicians and not from committee representations that are irrelevant to the banking sector. The results are shown in Table 7 and are in line with our expectation. Connections to unrelated committees (Senate Agriculture Committee and Senate Energy Committee) do not contribute to the mitigation of policy uncertainty, both statistically and economically.

[Insert Table 7 about here]

In the appendix, we try to further tease out the possible impact of economic conditions. First, in Table A2, we include year fixed effects or year*quarter fixed effects to control for common economic conditions that do not vary across states. In another specification, we further control for the interactions between our control variables and policy uncertainty. Second, in Table A3, we take into account the possibility that our results are driven by housing bubbles. To rule out this possibility, we control for the quarterly MSA-level housing-price growth rates from the Federal Housing Finance Agency.[2] It is also documented in the literature that there is a negative correlation between uncertainty and business cycles (e.g., Bloom, 2014). So, our results may capture the impact of recessions. To address this issue, we control for economic recessions defined by the National Bureau of Economic Research. There is a tight economic link between the US and Canada (e.g., Romalis, 2007). So, by extracting the US policy uncertainty index orthogonal to Canada's policy uncertainty index, we can eliminate the contaminating part of economic conditions (Gulen and Ion, 2016). Overall, in all specifications, our findings are robust.

[2] Notice that we lose more than one half of the observations because no housing price data are available where a great many banks are located.

4.4. Heterogeneity

The US banking market consists not only of some large banks but also a large number of relatively small banks. This banking market structure results largely from a legal framework that, in the past, restricted banks' ability to diversify geographically.

From a practical perspective, large banks usually have branches both in their home states and across several other states. As a result, these large banks are able to exert influence over senators beyond their home states. Large banks may also get connections with regulators of FDIC and the Federal Reserve System. This is also true even if a large bank has branches only in its home state, because large banks often have more resources to lobby and exert influence beyond senators from their home states. Therefore, Senate Banking Committee representation from their home states might not be that important for large banks. For instance, the Bank of America and Wells Fargo are two of the "Big Four" banks in the US, with operations all over the country. Their headquarters are based in North Carolina and California, respectively. However, their influence is deemed to be so far beyond their home states that they are able to lobby directly high-ranked officials in Washington DC and New York City.

In contrast, smaller banks, which mostly operate within their home states and lack sufficient resources to lobby, are more likely to be affected by their home state representation in the Senate Banking Committee. Examples include small banks that often have the name of the states in their names; e.g., the First Texas Bank and the Bank of Arkansas. At the same time, the large number of small banks are important in stimulating the local economy and stabilizing the employment, so senators are likely to show no less concern about these small banks compared to their larger peers. Therefore, Senate Banking Committee representation from their home states is likely to be more crucial for small banks.

To examine if this is the case, we divide our banks into large and small ones based on their total assets. We consider banks with total assets larger than the 75th percentile as large banks and the remaining ones as small banks. The results are shown in Table 8. Generally, we find that both large and small banks are more conservative during times of high policy uncertainty. The economic magnitudes are also comparable, indicating that both large and small banks are affected by

economic policy uncertainty in a similar way. Interestingly, we find that the mitigating effect of political connection is valid only for small banks and not for large ones. This is in line with our expectation that Senate Banking Committee representation is more important for small banks than it is for large banks. The scope of large banks in influencing regulators goes well beyond the state borders.

[Insert Table 8 about here]

This finding is important for policy makers, because small banks play a critical role in the US banking system and are particularly important in rural and small metropolitan areas. Small banks are key providers of certain products, such as small business loans and farm loans. The community focus of small banks enables them to develop and maintain relationships with customers in a way that large banks without a deep local presence cannot. Through these interactions, they obtain information about borrowers that large banks generally do not have. As a result, small banks are able to make loans to borrowers who might not qualify under large banks' standardized lending criteria.

During our sample period from 1985 to 2013, the banking regulation framework in the US changed dramatically. Before the 1990s, the banking sector was under strict regulations. This period ended gradually with a series of deregulations. Starting with the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, interstate banking restrictions were eliminated gradually in two phases. The first phase was September 29, 1995 when well-managed and well-capitalized banks were allowed to acquire banks in other states. The second phase followed on June 1, 1997, when banks in different states were allowed to merge into truly nationwide banks. The Glass–Steagall Act of 1933 was also partially repealed by the Gramm–Leach–Bliley Act enacted on November 12, 1999, which allowed consolidation among commercial banks, investment banks, securities' firms, and insurance companies. So, after 2000, the banking market in the US was in a period with much less regulation, until the collapse that was the 2008/09 financial crisis. In response to the crisis, the Dodd–Frank Wall Street Reform and Consumer Protection Act was enacted on July 21, 2010. The law overhauled the financial regulation in the aftermath of the financial crisis, and it made changes affecting all federal financial regulatory agencies and almost every part of the nation's financial services' industry. Once again, regulation of the banking market became stricter.

Therefore, there are three clearly different phases during our sampling period based on the strictness of banking market regulations; these phases are pre-2000, between 2000 and 2010, and post-2010. Regulations were much tighter in the pre-2000 and post-2010 periods but were significantly loosened in between. As the impact of political connections is related closely to the level of regulation that banks face, we would naturally expect a stronger impact whenever regulation is stricter.

This is examined empirically in Table 9. The estimates show that the role of political connections in mitigating the adverse effects of policy uncertainty on banks is stronger before 2000 and after 2010, when the banking industry was regulated strictly. However, the impact is much weaker, or even disappears, in between. One possible explanation is that the rent arising from political connections in times of high policy uncertainty declines after the implementation of bank deregulation.

[Insert Table 9 about here]

5. Conclusion

The global financial crisis has created concerns about policy uncertainty among practitioners and regulators around the world. More recently, the concerns have been intensifying in the face of rising political polarization, the increase in populism and nationalism, the changing role of the government, and the growing number of uncertainty-increasing events such as the Brexit and the trade war between the US and China.

Policy uncertainty has been treated as detrimental for firms. More importantly, policy uncertainty is largely out of managerial control and entails a systemic risk for the whole economy. There is limited evidence on how policy-induced economic uncertainty might influence banks' decision-making. However, there is a clear lack of research on how to alleviate the adverse effect of policy uncertainty on banks.

In this paper, we partially fill this gap to show that banks are more conservative in lending when facing high policy uncertainty, but this adverse effect is alleviated when banks are politically connected. Economically, for an increase of one standard deviation in the policy uncertainty index, connected banks would maintain a loss provision to loan volume ratio that is almost 7 percent lower

compared to that of unconnected banks. The findings are robust to both a geographical regression discontinuity design and a placebo test.

We further validate our findings by examining the heterogeneity across banks with different sizes and over time with changing levels of regulatory strictness. First, we find our results to be driven mainly by smaller banks that operate mostly within their home states and, thus, are more likely to be affected by their home state representation in the Senate Banking Committee. Second, as the rent arising from political connections would decrease in times of loosened regulations, we find the role of political connections in mitigating the adverse effect of policy uncertainty is less pronounced during 2000 and 2010, when banking regulation was weaker.

Our research is also relevant for policy makers. Government authorities are taking various actions to reduce the level of uncertainty in their legislative process. However, little is known on how financial institutions react to these uncertainties, and even less is known about how they can deal with the adverse effect of policy uncertainty. This paper provides evidence that access to political insiders is helpful in reducing the negative impact of policy uncertainty. Theoretically, political connections can provide banks with better access to legislative proposals under consideration and superior understanding of how policymakers will react to various alternatives. This is beneficial. However, access to political resources might also reduce the cost of making the "wrong" decision and induce banks to take on more risk. This moral hazard issue may harm the stability of the financial system and significantly increase the tax burden.

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Table 1. Variable definitions and sources

Variable	Definitions	Sources
Loan volume	Log amount of total loans normalized by CPI (2013 $1,000)	Call Reports
Loss provision	Log amount of loan loss provisions normalized by CPI (2013 $1,000)	Call Reports
Loss provision/Loan volume	Percentage ratio of loan loss provisions to total loans	Call Reports
Policy uncertainty	US economic policy uncertainty index minus its time-series mean and divided by its time-series standard deviation	Baker, Bloom, and Davis (2016)
Connected bank	Dummy=1 if the bank is headquartered in a state that is represented on the Senate Banking Committee	Congressional Research Service Report
Agriculture committee	Dummy=1 if the bank is headquartered in a state that is represented on the Senate Agriculture Committee	Congressional Research Service Report
Energy committee	Dummy=1 if the bank is headquartered in a state that is represented on the Senate Energy Committee	Congressional Research Service Report
Total assets	Log amount of total assets normalized by CPI (2013 $1,000)	Call Reports
ROA	Net income scaled by total assets	Call Reports
ROA volatility	Standard deviation of ROA in the current and the last seven quarters	Call Reports
Dividend ratio	Dividends scaled by total assets	Call Reports
Cash ratio	Cash holdings scaled by total assets	Call Reports
Distance to border	Distance to a state border	Holmes (1998)
Housing bubble	Quarterly MSA-level median housing price growth rate	Federal Housing Finance Agency
Economic recession	Dummy=1 if the current quarter is defined as a recession by NBER	NBER
Canada's policy uncertainty	Canada economic policy uncertainty index minus its time-series mean and divided by its time-series standard deviation	Baker, Bloom, and Davis (2016)

This table includes the variable definitions and data sources.

Table 2. Summary statistics

Variable	Obs.	Mean	Std.	Min.	Max.
Loan volume	877,448	11.331	1.395	2.385	20.525
Loss provision	877,448	5.198	1.858	-0.004	17.276
Loss provision/Loan volume	877,448	0.540	1.385	0	100
Policy uncertainty	877,448	0.010	0.928	-1.479	3.515
Connected bank	877,448	0.443	0.497	0	1
Agriculture committee	877,448	0.412	0.492	0	1
Energy committee	877,448	0.282	0.450	0	1
Total assets	877,448	11.861	1.306	7.198	21.378
ROA	877,448	0.005	0.013	-0.535	3.940
ROA volatility	877,448	0.004	0.009	0.000	1.885
Dividend ratio	877,448	0.002	0.026	-0.001	13.961
Cash ratio	877,448	0.065	0.056	-0.002	0.979
Distance to border	848,836	52.679	56.391	0	396
Housing bubble	350,915	0.007	0.020	-0.302	0.261
Economic recession	877,448	0.099	0.298	0	1
Canada's policy uncertainty	877,448	-0.083	0.918	-1.222	4.016

This table reports the summary statistics for all variables.

Table 3. Policy uncertainty, political connection, and risk taking: Univariate

	Unconnected bank	Connected bank	
Low policy uncertainty	0.348	0.480	0.132***
High policy uncertainty	0.717	0.671	-0.046***
	0.369***	0.191***	*0.178***

This table reports the univariate results of a difference-in-differences setting. The variable of interest is the *Loss provision/Loan volume* ratio and the differences are calculated using a t-test with unequal variance.

Table 4. Policy uncertainty, political connection, and risk taking: Multivariate

Dependent Variable	Loss provision/Loan volume					
Model	(1)	(2)	(3)	(4)	(5)	(6)
Policy uncertainty * Connected bank				-0.036***	-0.035***	-0.027***
				[0.006]	[0.005]	[0.004]
Policy uncertainty	0.107***	0.081***	0.086***	0.123***	0.095***	0.097***
	[0.007]	[0.010]	[0.008]	[0.009]	[0.011]	[0.009]
Connected bank				0.023***	0.018***	-0.008
				[0.007]	[0.006]	[0.006]
Total assets	-0.018***	-0.001	-0.048***	-0.019***	-0.001	-0.048***
	[0.007]	[0.008]	[0.015]	[0.007]	[0.008]	[0.015]
ROA	-31.315***	-32.424***	-26.843***	-31.275***	-32.418***	-26.832***
	[4.922]	[5.477]	[6.259]	[4.920]	[5.477]	[6.258]
ROA volatility	48.022***	46.941***	35.431***	47.981***	46.933***	35.421***
	[14.689]	[14.302]	[12.039]	[14.686]	[14.300]	[12.035]
Dividend ratio	5.796***	6.005***	4.760***	5.796***	6.005***	4.760***
	[1.893]	[1.995]	[1.762]	[1.894]	[1.996]	[1.762]
Cash ratio	0.562***	0.437***	0.263**	0.541***	0.432***	0.263**
	[0.122]	[0.094]	[0.104]	[0.120]	[0.094]	[0.104]
Quarter FE	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes
R-squared	0.152	0.202	0.370	0.152	0.202	0.370
Observations	877,448	877,448	877,448	877,448	877,448	877,448

This table shows the multivariate regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table 5. Policy uncertainty, political connection, and risk taking: Geographical regression discontinuity

Dependent Variable	Loss provision/Loan volume					
	Distance to border <= 40km			Distance to border <= 50km		
Model	(1)	(2)	(3)	(4)	(5)	(6)
Policy uncertainty * Connected bank	-0.046***	-0.046***	-0.023***	-0.047***	-0.043***	-0.017***
	[0.007]	[0.006]	[0.005]	[0.007]	[0.006]	[0.005]
Policy uncertainty	0.131***	0.108***	0.106***	0.131***	0.105***	0.101***
	[0.013]	[0.017]	[0.013]	[0.012]	[0.014]	[0.012]
Connected bank	-0.029***	-0.023***	-0.025***	-0.015***	-0.018***	-0.019***
	[0.008]	[0.010]	[0.009]	[0.008]	[0.009]	[0.008]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes
R-squared	0.120	0.174	0.338	0.114	0.167	0.342
Observations	459,587	459,587	459,587	526,057	526,057	526,057

This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking for the subsample of banks that is located within 40km/50km to the state borders. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table 6. Policy uncertainty, political connection, and risk taking: States subsample

Dependent Variable	Loss provision/Loan volume								
	States excluding NY			Ever-connected states			Ever-connected states excluding		
Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Policy uncertainty * Connected bank	-0.035***	-0.033***	-0.025***	-0.037***	-0.035***	-0.027***	-0.035***	-0.032***	-0.025***
	[0.006]	[0.005]	[0.004]	[0.006]	[0.005]	[0.005]	[0.006]	[0.005]	[0.005]
Policy uncertainty	0.123***	0.095***	0.097***	0.123***	0.095***	0.097***	0.123***	0.096***	0.097***
	[0.009]	[0.011]	[0.009]	[0.010]	[0.011]	[0.009]	[0.010]	[0.011]	[0.010]
Connected bank	0.028***	0.018***	-0.009	0.031***	0.021***	-0.005	0.035***	0.021***	-0.005
	[0.007]	[0.006]	[0.006]	[0.007]	[0.006]	[0.007]	[0.007]	[0.006]	[0.007]
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes	No	No	Yes
R-squared	0.152	0.202	0.371	0.147	0.198	0.370	0.146	0.197	0.371
Observations	860,491	860,491	860,491	800,111	800,111	800,111	783,154	783,154	783,154

This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking for subsample of states. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table 7. Policy uncertainty, political connection, and risk taking: Placebo test

Dependent Variable	Loss provision/Loan volume					
	Agriculture committee			Energy committee		
Model	(1)	(2)	(3)	(4)	(5)	(6)
Policy uncertainty * Connected bank	0.003	0.007	0.008*	-0.001	0.004	0.002
	[0.004]	[0.005]	[0.004]	[0.005]	[0.004]	[0.004]
Policy uncertainty	0.105***	0.078***	0.082***	0.108***	0.082***	0.085***
	[0.009]	[0.011]	[0.009]	[0.008]	[0.010]	[0.008]
Connected bank	0.022**	0.013**	0.024***	-0.001	-0.050***	-0.046***
	[0.009]	[0.006]	[0.006]	[0.006]	[0.007]	[0.007]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes
R-squared	0.152	0.202	0.370	0.152	0.202	0.370
Observations	877,448	877,448	877,448	877,448	877,448	877,448

This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking for other important senate committees including agriculture and energy. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table 8. Policy uncertainty, political connection, and risk taking: Bank size

Dependent Variable	Loss provision/Loan volume					
	Larger banks (assets >= 75 percentile)			Smaller banks (assets < 75 percentile)		
Model	(1)	(2)	(3)	(4)	(5)	(6)
Policy uncertainty * Connected bank	-0.015*	-0.008	-0.007	-0.039***	-0.042***	-0.031***
	[0.008]	[0.008]	[0.008]	[0.006]	[0.005]	[0.004]
Policy uncertainty	0.138***	0.102***	0.095***	0.119***	0.092***	0.086***
	[0.008]	[0.008]	[0.007]	[0.009]	[0.011]	[0.008]
Connected bank	0.046***	0.045***	0.022*	0.009	0.003	-0.018***
	[0.014]	[0.012]	[0.012]	[0.007]	[0.007]	[0.006]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes
R-squared	0.089	0.158	0.378	0.196	0.241	0.424
Observations	219,433	219,433	219,433	658,015	658,015	658,015

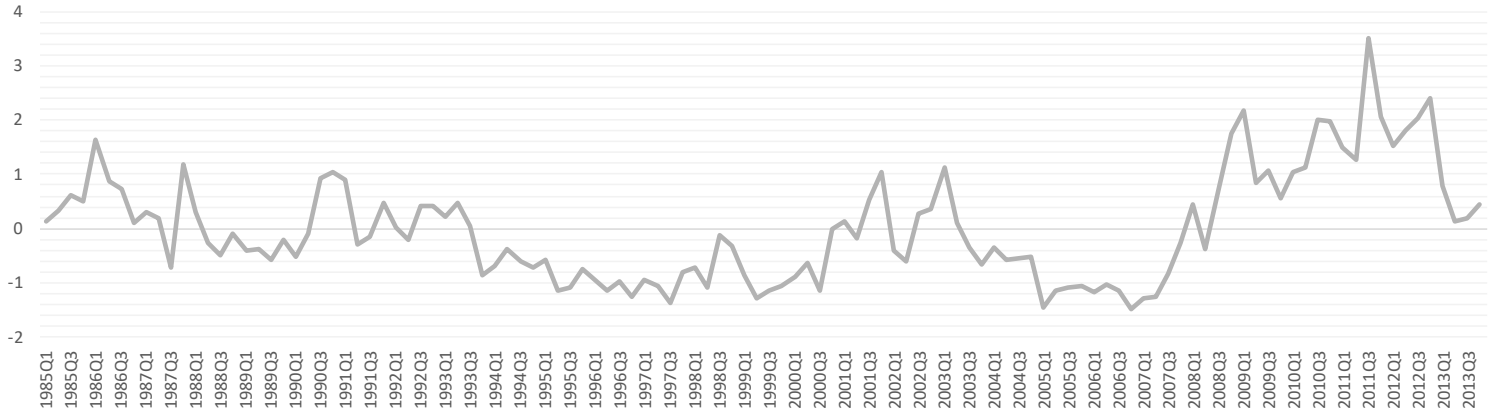
This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking for the subsample of large and small banks separately. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table 9. Policy uncertainty, political connection, and risk taking: Time periods

Dependent Variable	Loss provision/Loan volume								
	Pre-2000			Between 2000 and 2010			Post-2010		
Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Policy uncertainty * Connected bank	-0.079***	-0.085***	-0.076***	-0.017**	-0.022***	-0.009	-0.012*	-0.024***	-0.026***
	[0.008]	[0.007]	[0.008]	[0.008]	[0.008]	[0.007]	[0.007]	[0.007]	[0.007]
Policy uncertainty	0.263***	0.242***	0.178***	0.113***	0.083***	0.078***	0.175***	0.107***	0.103***
	[0.012]	[0.013]	[0.007]	[0.007]	[0.010]	[0.004]	[0.005]	[0.005]	[0.005]
Connected bank	-0.039***	-0.113***	-0.095***	0.026*	0.028	0.005	-0.005	0.002	0.022
	[0.011]	[0.010]	[0.009]	[0.013]	[0.019]	[0.010]	[0.010]	[0.015]	[0.015]
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes	No	No	Yes
R-squared	0.162	0.224	0.383	0.196	0.229	0.519	0.226	0.296	0.548
Observations	544,140	544,140	544,140	247,864	247,864	247,864	85,444	85,444	85,444

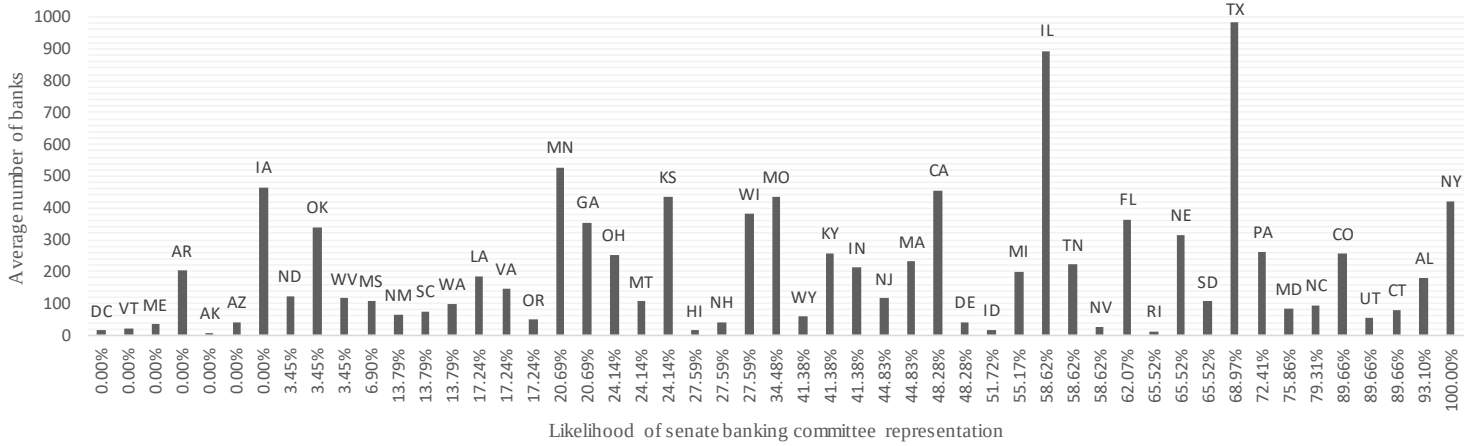
This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking for the subsample before and after year 2000 separately. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Figure 1. Time trends of economic policy uncertainty



This figure shows the time trends of economic policy uncertainty in the US.

Figure 2. Correlation between bank density and banking committee representation



This figure shows the correlation between bank density and senate banking committee representation in our sample, the correlation is 0.187 with insignificance at the 10 percent level.

Table A1. Policy uncertainty, political connection, and risk taking: Decomposition

Dependent Variable	Loan volume			Loss provision		
Model	(1)	(2)	(3)	(4)	(5)	(6)
Policy uncertainty * Connected bank	0.015***	0.022***	0.014***	-0.034***	-0.025***	-0.022***
	[0.002]	[0.001]	[0.001]	[0.006]	[0.005]	[0.005]
Policy uncertainty	-0.013***	-0.014***	-0.015***	0.263***	0.236***	0.242***
	[0.001]	[0.001]	[0.001]	[0.007]	[0.008]	[0.006]
Connected bank	-0.035***	-0.030***	-0.025***	0.043***	0.059***	0.023***
	[0.003]	[0.002]	[0.002]	[0.008]	[0.008]	[0.008]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes
R-squared	0.953	0.956	0.981	0.544	0.640	0.738
Observations	877,448	877,448	877,448	877,448	877,448	877,448

This table shows the decomposition of *Loss provision/Loan volume* ratio. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table A2. Policy uncertainty, political connection, and bank risk taking: Stricter FE and controls

Dependent Variable	Loss provision/Loan volume					
Model	(1)	(2)	(3)	(4)	(5)	(6)
Policy uncertainty * Connected bank	-0.025***	-0.018***	-0.026***	-0.019***	-0.031***	-0.027***
	[0.004]	[0.004]	[0.004]	[0.004]	[0.006]	[0.005]
Policy uncertainty	-0.031***	-0.032***			0.180***	0.004
	[0.003]	[0.003]			[0.059]	[0.038]
Connected bank	-0.022***	-0.025***	-0.021***	-0.024***	0.022***	-0.006
	[0.006]	[0.007]	[0.006]	[0.007]	[0.007]	[0.007]
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Interacted controls	No	No	No	No	Yes	Yes
Quarter FE	Yes	Yes	No	No	Yes	Yes
Year FE	Yes	Yes	No	No	No	No
Year * Quarter FE	No	No	Yes	Yes	No	No
State FE	Yes	No	Yes	No	Yes	No
Bank FE	No	Yes	No	Yes	No	Yes
R-squared	0.224	0.382	0.235	0.394	0.209	0.377
Observations	877,448	877,448	877,448	877,448	877,448	877,448

This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking with stricter fixed effects or a set of interacted controls.Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

Table A3. Policy uncertainty, political connection, and risk taking: Economic conditions

Dependent Variable	Loss provision/Loan volume								
Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Policy uncertainty * Connected bank	-0.017**	-0.020***	-0.012*	-0.049***	-0.044***	-0.035***	-0.071***	-0.080***	-0.078***
	[0.008]	[0.007]	[0.007]	[0.007]	[0.005]	[0.005]	[0.007]	[0.006]	[0.007]
Policy uncertainty	0.093***	0.071***	0.081***	0.141***	0.111***	0.109***	0.025***	0.217***	0.188***
	[0.012]	[0.014]	[0.011]	[0.009]	[0.011]	[0.009]	[0.014]	[0.015]	[0.011]
Housing bubble * Connected bank	-1.000**	-0.520	0.330						
	[0.418]	[0.396]	[0.336]						
Housing bubble	-4.837***	-4.343***	-4.078***						
	[0.773]	[0.735]	[0.496]						
Economic recession * Connected bank				0.129***	0.085***	0.078***			
				[0.014]	[0.012]	[0.011]			
Economic recession				-0.181***	-0.153***	-0.107***			
				[0.007]	[0.007]	[0.007]			
Canada's policy uncertainty * Connected bank							0.049***	0.060***	0.071***
							[0.005]	[0.005]	[0.006]
Canada's policy uncertainty							-0.127***	-0.192***	-0.142***
							[0.009]	[0.008]	[0.005]
Connected bank	0.076***	0.056***	0.020*	0.010	0.007	-0.017***	0.027***	0.020***	-0.002
	[0.012]	[0.011]	[0.010]	[0.007]	[0.006]	[0.007]	[0.007]	[0.006]	[0.006]
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Quarter FE	No	Yes	Yes	No	Yes	Yes	No	Yes	Yes
State FE	No	Yes	No	No	Yes	No	No	Yes	No
Bank FE	No	No	Yes	No	No	Yes	No	No	Yes
R-squared	0.138	0.187	0.411	0.153	0.203	0.370	0.155	0.209	0.373
Observations	350,915	350,915	350,915	877,448	877,448	877,448	877,448	877,448	877,448

This table shows the regressions to estimate the relationship between economic policy uncertainty, political connection, and bank risk taking whle controlling for various measures of economic conditions. Coefficients are listed in the first row, robust bank clustered standard errors are reported below in the brackets, and the corresponding significance levels are placed adjacently. *** Significant at 1%, ** significant at 5%, * significant at 10%.

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c/o University of Geneva, Bd. Du Pont d'Arve 42, CH-1211 Geneva 4
T +41 22 379 84 71, rps@sfi.ch, www.sfi.ch